

**STATE OF NORTH DAKOTA  
BISMARCK, NORTH DAKOTA**

**REPORT OF EXAMINATION  
OF  
DAKOTA FIRE INSURANCE COMPANY  
BISMARCK, NORTH DAKOTA**

**AS OF  
DECEMBER 31, 2003**

STATE OF NORTH DAKOTA  
DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that I have compared the annexed copy of the Report of Examination of the

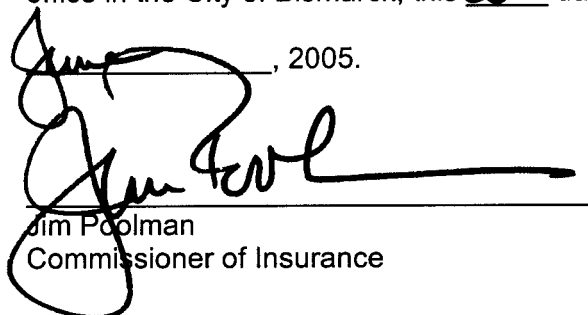
**Dakota Fire Insurance Company**

**Bismarck, North Dakota**

as of December 31, 2003, with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.



IN WITNESS WHEREOF, I have hereunto  
set my hand and affixed my official seal at my  
office in the City of Bismarck, this 20<sup>th</sup> day of  
June, 2005.

  
Jim Poolman  
Commissioner of Insurance

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Des Moines, Iowa  
June 14, 2005

Honorable Alfred W. Gross  
Chair, Financial Condition Committee  
Subcommittee, NAIC  
Commissioner  
Bureau of Insurance  
Commonwealth of Virginia  
P.O. Box 1157  
Richmond, VA 23218

Honorable Jorge Gomez  
Secretary, Midwestern Zone  
Commissioner of Insurance  
State of Wisconsin  
125 South Webster Street  
GEF III – 2<sup>nd</sup> Floor  
Madison, WI 53702

Honorable Jim Poolman  
Commissioner of Insurance  
North Dakota Department of Insurance  
600 East Boulevard  
Bismarck, ND 58505-0320

Dear Commissioners:

Pursuant to your instructions and statutory requirements, a financial examination has been made of the books, records, and financial condition of

**Dakota Fire Insurance Company**

**Bismarck, North Dakota**

hereinafter referred to as the "Company." The examination was conducted at the Company's main administrative office located at 717 Mulberry Street, Des Moines, Iowa. The Company was last examined as of December 31, 1999. The report of examination is herewith respectfully submitted.

**SCOPE OF EXAMINATION**

This examination was a financial condition examination conducted in accordance with N.D. Cent. Code § 26.1-03-19.3 and observed guidelines and procedures contained in the National Association of Insurance Commissioners (NAIC) Examiners Handbook. The examination was conducted to determine the Company's financial condition, its compliance with statutes, and to review the corporate affairs and insurance operations. This statutory examination covers the four-year period beginning January 1, 2000, and ending December 31, 2003, and includes a

review and analysis of the Company's operations, verification of assets, and valuation of liabilities as of December 31, 2003. Any material transactions and/or events occurring subsequent to the examination date have also been considered where relevant to the Company's current condition.

Workpapers provided by the Company's independent certified public accountants and the Iowa Insurance Division were reviewed and where deemed appropriate, certain procedures and conclusions documented in those workpapers have been relied upon and copied for inclusion into the working papers for this examination.

The Company is a member of the EMC Insurance Group Inc. (an insurance holding company domiciled in Iowa, hereinafter referred to as "EMC Group"). The members of the EMC Group were examined by the Iowa Insurance Division as of December 31, 2003, and that examination was conducted concurrently with this examination. Due to the "Reinsurance Pooling Agreement" between the Company and Employers Mutual Casualty Company (hereinafter referred to as "EMC"), the Company did not report net premium income during the period under examination except that assumed from EMC. The Iowa Insurance Division made available their workpapers relative to the EMC Group as a whole and each separate entity.

The Company's statutory home office is located at 1838 East Interstate Avenue, Bismarck, North Dakota; however, its principal administrative office is located at 717 Mulberry Street, Des Moines, Iowa, the home office of EMC.

All recommendations made in the prior statutory examination report have been adequately addressed by the Company.

This examination was conducted by an Examiner from the North Dakota Insurance Department representing the Midwestern Zone.

## **HISTORY**

### **General**

The Company was incorporated on August 23, 1957, as a stock insurance company under the provisions of Chapters 10-02 and 26-08 of the North Dakota Revised Code of 1943, and amendments thereto, as the "Dakota Fire Insurance Company" with its home office and principal place of business in the city of Bismarck, North Dakota. The Company commenced business on January 10, 1958. In 1973, Employers Mutual Casualty Company assumed control of the Company by acquiring 78 percent of outstanding shares. Through subsequent purchases of stock and a series of affiliated transactions, ownership of the Company was transferred to EMC Insurance Group Inc. in 1981.

The Articles of Incorporation provide that the Company may carry the lines of insurance as authorized under N.D. Cent. Code § 26.1-05-02.

### **Capital Stock**

As of December 31, 2003, 1,500,000 shares of common stock were outstanding and 100 percent of outstanding shares were held by EMC Insurance Group Inc.

### **Surplus Notes**

Effective December 28, 2001, the Company issued a \$6,000,000 surplus note to Employers Mutual Casualty in exchange for cash. The principal amount of the note and interest thereon shall be repaid only out of surplus earnings of the Company. Interest on the surplus note is payable annually on January 1 of each year.

The following interest rates were in effect during the period examination:

December 28, 2001 thru March 31, 2003	5.38%
April 1, 2003 thru December 31, 2003	3.09%

All principal and interest payments require the prior approval of the Commissioner.

### **Dividends to Stockholders**

Dividends paid to the shareholder, as reported in the Company's annual statement, are as follows:

2000	\$ 525,000
2001	525,000
2002	1,050,000
2003	1,050,000

## **MANAGEMENT AND CONTROL**

### **Shareholders**

The regular annual meeting of the shareholders shall be held within the first six months of each year, at such date and time as shall be fixed by the Chief Executive Officer or the Board of Directors, for the purpose of electing directors and for the transaction of such other business as may come before the meeting.

A majority of the outstanding shares of the Company entitled to vote, represented in person or by proxy, shall constitute a quorum at a meeting of the shareholders.

### **Board of Directors**

The Bylaws provide that the general control and management of the Company shall be vested in a Board of 14 directors. Each director shall hold office until the next annual meeting of the shareholders and until his or her successor shall have been elected and qualified.

A regular meeting of the Board of Directors shall be held without notice immediately after, and at the same place as, the annual meeting of shareholders.

A majority of the number of directors fixed by the Bylaws constitutes a quorum for the transaction of business at any meeting of the Board of Directors, but if less than such majority is present at a

meeting, a majority of the directors present may adjourn the meeting from time to time without further notice.

Duly elected members serving on the Board of Directors as of December 31, 2003, were as follows:

<b>Name and Address</b>	<b>Principal Business Affiliation</b>
John Wesley Carlisle Park Rapids, Minnesota	Retired - Former Real Estate Developer
Maurice Oscar Cooper Urbandale, Iowa	Retired - Former Senior Vice President Employers Mutual Casualty Company
Merle Lee Croy, Jr. Bismarck, North Dakota	Retired - Former President, Treasurer, and COO Dakota Fire Insurance Company
Raymond Wesley Davis Urbandale, Iowa	Senior Vice President Investments & Treasurer Dakota Fire Insurance Company
Kenneth William DeKrey Valley City, North Dakota	Assistant Vice President Farmers Merchants Bank of Valley City
Dennis James Prindiville Bismarck, ND	President, Treasurer & Chief Operating Officer Dakota Fire Insurance Company
William Allan Murray Waukee, Iowa	Executive Vice President & Chief Operating Officer Employers Mutual Casualty Company
Kent Mason Forney Waukee, Iowa	Shareholder in law firm of Bradshaw, Fowler, Proctor and Fairgrave
Alan Dale Huisinga Carlisle, Iowa	President and Chief Operating Officer EMC National Life Company
Bruce Gunn Kelley Des Moines, Iowa	President and Chief Executive Officer Employers Mutual Casualty Company
George William Kochheiser Scottsdale, Arizona	Retired - Former President Employers Mutual Casualty Company
Evan Edwin Lips Bismarck, North Dakota	Principal in the Lips and Lahr Insurance Agency
Fredrick Arnold Schiek Urbandale, Iowa	Retired Executive Vice President and Chief Operating Officer Employers Mutual Casualty Company
Thomas Xavier Wright Des Moines, Iowa	Retired - Former Senior Vice President Employers Mutual Casualty Company

## **Officers**

The executive officers of the Company are a chairman, one or more vice chairmen, a president, one or more executive vice presidents, one or more senior vice presidents, one or more vice presidents, a secretary, a treasurer, and a general counsel, each of whom shall be elected annually by the Board of Directors at its regular annual meeting. The Board may also elect or appoint one or more resident vice presidents, an actuary, a controller, and any assistant officers it may deem necessary. Any executive office, except that of president, one vice president, treasurer, and secretary, may be left unfilled. Any two or more offices may be held by the same person except the offices of president and secretary.

Duly elected or appointed officers serving as of December 31, 2003, were as follows:

<b><u>Name</u></b>	<b><u>Office</u></b>
Bruce G. Kelley	Chairman and Chief Executive Officer
Evans E. Lips	Vice Chairman of the Board
Dennis J. Prindiville	President, Treasurer and Chief Operating Officer
William A. Murray	Executive Vice President
Ronald W. Jean	Executive Vice President - Corporate Development
Mark E. Reese	Vice President, Assistant Treasurer and Chief Financial Officer
Raymond W. Davis	Senior Vice President - Investments
Steven C. Peck	Senior Vice President - Actuary
David L. Hixenbaugh	Vice President
Vernon L. Jurgens	Vice President
Kevin J. Hovick	Senior Vice President – Business Development
Robert L. Link	Secretary
Richard W. Hoffmann	Vice President and General Counsel
Donald L. Coughenower	Assistant Vice President and Assistant Secretary
Robert J. Ruby	Assistant Vice President
Jeffrey L. Lawler	Assistant Secretary
Jeffrey S. Birdsley	Assistant Secretary
Carla A. Prather	Assistant Vice President and Controller

## **Committees**

The Board of Directors at its regular annual meeting appoints an Executive Committee and may appoint such other committees as it may deem necessary. All committees shall consist of three or more directors. The chief executive officer of the Company shall be a member and chairman of the Executive Committee and may be a member of any other committee.

Appointed committees are as follows:

### **Executive Committee**

William A. Murray  
Bruce G. Kelley  
Dennis J. Prindiville

### **Investment Committee**

Bruce G. Kelley  
George Kochheiser  
Raymond W. Davis



## CONFLICT OF INTEREST

The Board of Directors adopted a policy statement to ensure prompt disclosure of any possible conflict of interest on the part of its directors, officers, and employees. Conflict of interest statements executed during the period under examination were reviewed with no material conflicts noted.

## CORPORATE RECORDS

The recorded minutes of the Shareholders, Board of Directors, and Investment Committee meetings were read with no differences noted.

The Articles of Incorporation were not amended or substituted during the period covered by this examination. The Board of Directors approved the following amendments to the Bylaws during the period under examination:

Article IV, Section 1 – Executive Officers - Was amended to permit more than one individual to hold the title of Executive Vice President of the Company.

Article IV, Section 10 – The Vice Presidents - Was restated to describe the reporting relationships and duties of vice presidents.

The amendments were approved at the June 3, 2001, Board of Directors meeting.

## HOLDING COMPANIES, SUBSIDIARIES, AND AFFILIATES

The organization chart for the Employers Mutual Casualty Company Group is as follows:

<u>Corporate Name</u>	<u>Domicile</u>	<u>Voting Control</u>
Employers Mutual Casualty Company (EMC)	Iowa	
Hamilton Mutual Insurance Company	Ohio	EMC controls Board of Directors
EMC Risk Services, Inc.	Iowa	100% held by EMC
Union Insurance Company of Providence	Iowa	100% held by EMC
EMC Property & Casualty Company	Iowa	100% held by EMC
EMC Insurance Group Inc.	Iowa	81% held by EMC 19% publicly held
EMCASCO Insurance Company	Iowa	100% held by Group Inc.
EMC Underwriters, LLC	Iowa	100% held by EMCASCO
Illinois EMCASCO Insurance Company	Iowa	100% held by Group Inc.
Dakota Fire Insurance Company	North Dakota	100% held by Group Inc.
EMC Reinsurance Company	Iowa	100% held by Group Inc.

<b><u>Corporate Name</u></b>	<b><u>Domicile</u></b>	<b><u>Voting Control</u></b>
Farm and City Insurance Company	Iowa	100% held by Group Inc.
EMC National Life Mutual Holding Company (NLMHC)	Iowa	
EMC National Company	Iowa	100% held by NLMHC
EMC National Life Company	Iowa	EMC owns 36.75%, Hamilton Mutual owns 12.25%
National Travelers Investment Company	Iowa	100% held by EMC Nat'l. Life
EML Marketing Services, Inc.	Iowa	100% held by EMC Nat'l. Life
The Bank Market Company	Iowa	100% held by NT Investment

## **FIDELITY BOND AND OTHER INSURANCE**

At December 31, 2003, there was in force two Financial Institution Bonds in which the Company was a named insured along with Employers Mutual Casualty Company and its other affiliated entities with a basic limit of \$15,000,000. The aggregate indemnity provided under these bonds exceeds the minimum amount of fidelity insurance suggested by the NAIC.

Other insurance coverages in place appeared adequate.

## **INTERCOMPANY AGREEMENTS**

The Company has no agreements with its parent or affiliates other than the reinsurance pooling agreement described herein.

## **EMPLOYEE BENEFITS**

The Company has no employees; all employees are classified as employees of Employers Mutual Casualty Company.

Employees of EMC receive retirement benefits, group health and dental insurance, group life insurance, group long-term disability income, and group accidental death and dismemberment indemnity for qualified employees. The cost of retirement benefits, life insurance, and long-term disability income for the employees is borne by EMC. The employees may participate in a stock purchase plan utilizing EMC Insurance Group, Inc. stock and voluntarily contribute to a 401(k) savings plan wherein EMC will match a portion of the employee's contribution.

## **STATUTORY DEPOSIT**

The statement value of securities held in a custodial account and vested in the North Dakota Commissioner of Insurance for the benefits of all policyholders totaled \$999,789 at December 31, 2003.

## **TERRITORY AND PLAN OF OPERATION**

Certificates of Authority evidenced that the Company was authorized to transact business at December 31, 2003, in the following jurisdictions:

Idaho	Montana
North Dakota	Minnesota
South Dakota	

The Company operates on the American Agency System and local agents are under one basic contract that provides for commissions on a graded basis. As of December 31, 2003, approximately 267 agencies were licensed by the Company.

Dividends to policyholders are paid on an annual basis. A resolution adopted by the Board of Directors in each of the four years under review authorized the payment of reasonable dividends in those states where the Company issued policies at standard board or bureau rates. In other states, it is generally the practice to deviate from standard board rates on the basis of loss experience.

The Company did not pay dividends on its policies. Dividends paid to policyholders reflect the dividends allocated to the Company under the pooling agreement and are reported in the filed annual statements as follows:

2000	\$ 425,013
2001	\$ 442,483
2002	\$ 513,720
2003	\$ 565,205

## **REINSURANCE**

Effective January 1, 1987, the Company entered a reinsurance pooling agreement with Employers Mutual Casualty Company whereby it cedes all liabilities under all policies of insurance in force. Such liabilities include reserves for unearned premiums, outstanding losses and loss adjustments expenses, and all the outstanding administrative expenses, not including inter-company balances, liabilities for corporate taxes including federal or state income taxes, or liabilities incurred in connection with investment transactions. The Company transfers to Employers Mutual Casualty Company amounts equal to the prepaid expenses.

Employers Mutual Casualty Company retrocedes five percent of its net liabilities back to the Company.

The term of the agreement is continuous and unlimited as to duration but may be terminated as of the end of any calendar year by agreement of the parties. The agreement also contains the usual insolvency clause as required by N.D. Cent. Code § 26.1-02-21.

Each company's participation in the pool as of December 31, 2003, is as follow:

Employers Mutual Casualty Company	65.5%
EMCASCO Insurance Company	9.0%
Illinois EMCASCO Insurance Company	8.0%
Dakota Fire Insurance Company	5.0%
Hamilton Mutual Insurance Company	5.0%
EMC Property & Casualty Company	3.5%
Union Insurance Company of Providence	2.5%
Farm and City Insurance Company	1.5%

Effective December 31, 2003, the pooling agreement was amended to provide that if the amounts produced by Employers Mutual Casualty's systems and/or computational processes, and relied upon by both Employers Mutual Casualty and its affiliated companies in implementing the pooling agreement, subsequently prove to be inaccurate or overstated to the extent that a restatement of the financial statements of one or more of the affiliated companies would otherwise be required, Employers Mutual Casualty guarantees to make up the shortfall or difference resulting from such error(s) in its systems and/or computational processes so that no such restatement of the financial statements of any affiliated company is required.

## **ACCOUNTS AND BALANCES**

The Company's general ledger and its annual statement are prepared at Employers Mutual Casualty Company offices.

Trial balances were extracted from the general ledger for the years 2000, 2001, 2002, and 2003. The amounts were in agreement with or reconciled to office copies of the filed annual statements.

As noted in the Reinsurance section of this report, underwriting and claims expenses exclusive of corporate income taxes are combined, subject to terms of the inter-company pooling agreement. The year-end expense accruals are determined on a group basis and the liabilities reported in the Company's annual statement represent its pro rata share, that being five percent of the group's combined total.

## **FINANCIAL STATEMENTS**

The following pages present a Statement of Assets, Liabilities, and Surplus as of December 31, 2003. This statement is followed by supporting statements and reconciliations presented in the following order:

Statement of Assets, Liabilities, and Surplus, December 31, 2003  
Summary of Operations for the Year Ending December 31, 2003  
Reconciliation of Capital and Surplus, December 31, 1999 to December 31, 2003

**Dakota Fire Insurance Company**  
**Statement of Assets, Liabilities and Surplus**  
**as of December 31, 2003**

	<b>Assets</b>	<b>Nonadmitted Assets</b>	<b>Net Admitted Assets</b>
Bonds	\$60,727,151		\$60,727,151
Common Stocks	11,547,913		11,547,913
Short-Term Investments	24,766,303		24,766,303
Other Invested Assets	775,988		775,988
Amounts Due from Investment Custodians	22		22
Investment Income Due and Accrued	1,106,934		1,106,934
Premiums and Considerations: Uncollected Premiums and Agents' Balances in the Course of Collection.	3,243,523		3,243,523
Deferred Premiums, Agents' Balances and Installments Booked but Deferred and Not Yet Due	237,872	\$23,787	214,085
Accrued Retrospective Premiums	96,897	9,690	87,207
Current Federal and Foreign Income Tax Recoverable and Interest Thereon	100,886		100,886
Net Deferred Tax Asset	3,571,564	1,167,162	2,404,402
Guaranty Funds Receivable or on Deposit	318,630		318,630
Other Prepaid Expenses	66,095	66,095	
Defined Benefit Plan Intangible Asset	33,131	33,131	
Defined Contribution Plan Prepaid Expenses	28,526	28,526	
Totals	\$106,621,435	\$1,328,391	\$105,293,044

**Dakota Fire Insurance Company**  
**Statement of Assets, Liabilities and Surplus**  
**as of December 31, 2003**

Losses		\$ 40,254,372
Reinsurance Payable on Paid Loss and Loss Adjustment Expenses		2,757,804
Loss Adjustment Expenses		10,281,123
Commissions Payable, Contingent Commissions and Other Similar Charges		1,314,292
Other Expenses		1,185,957
Taxes, Licenses, and Fees		839,009
Borrowed Money		139,050
Unearned Premiums		22,093,554
Payable to Parent, Subsidiaries, and Affiliates		1,078,293
Accrued Return Retrospective Premium		133,524
Defined Benefit Plan Minimum Liability		43,234
2002 North Carolina Private Passenger Auto Escrow		26,876
2003 North Carolina Private Passenger Auto Escrow		<u>22,803</u>
Total Liabilities		\$ 80,169,891
Common Capital Stock	\$ 1,500,000	
Surplus Notes	6,000,000	
Gross Paid in and Contributed Surplus	6,850,255	
Unassigned Funds (Surplus)	<u>10,772,898</u>	
Surplus as Regards Policyholders		<u>25,123,153</u>
Totals		<u>\$105,293,044</u>

**Dakota Fire Insurance Company  
Underwriting and Investment Exhibit  
for the Year Ended December 31, 2003**

**UNDERWRITING INCOME**

Premiums Earned		\$51,327,089
Deductions:		
Losses Incurred	\$29,139,595	
Loss Expenses Incurred	7,377,064	
Other Underwriting Expenses Incurred	16,538,612	
Aggregate Write-in Deductions	25,645	
Total Underwriting Deductions		<u>53,080,916</u>
Net Underwriting Gain or (Loss)		\$(1,753,827)

**INVESTMENT INCOME**

Net Investment Income Earned	\$ 4,119,323	
Net Realized Capital Gains or Losses	285,596	
Net Investment Gain or (Loss)		<u>4,404,919</u>

**OTHER INCOME**

Net Gain(Loss) from Agents' or Premium Balances Charged Off	\$ (64,969)	
Finance and Service Charges not Included in Premiums	29,965	
Aggregate Write-ins for Miscellaneous Income	11,852	
Total Other Income		<u>(23,152)</u>
Net Income Before Dividends to Policyholders and Before Federal Income Taxes		\$ 2,627,940
Dividends to Policyholders		<u>565,205</u>
Net Income Before Federal Income Taxes		\$ 2,062,735
Federal Income Taxes Incurred		<u>826,343</u>
Net Income		<u><u>\$ 1,236,392</u></u>

**Dakota Fire Insurance Company**  
**Reconciliation of Capital and Surplus Account**  
**December 31, 1999, Through December 31, 2003**

	2000	2001	2002	2003
Capital and Surplus, December 31, Prior Year	\$16,754,558	\$16,428,171	\$21,372,938	\$21,226,741
Net Income	(311,552)	(1,372,524)	2,344,892	1,236,392
Change in Net Unrealized Capital Gains or (Losses)	494,144	(201,903)	(1,409,061)	2,180,996
Change in Net Deferred Income Tax		678,773	(100,068)	268,181
Changes in Nonadmitted Assets	16,021	(1,137,025)	182,410	1,193,069
Change in Surplus Notes		6,000,000		
Cumulative Effect of Changes in Accounting Principles		1,502,446		
Dividends to Stockholders	(525,000)	(525,000)	(1,050,000)	(1,050,000)
Aggregate Write-ins for Gains and Losses in Surplus			(114,370)	67,774
Net Change in Capital and Surplus for the Year	\$(326,387)	\$4,944,767	\$(146,197)	\$3,896,412
Capital and Surplus, December 31, Current Year	\$16,428,171	\$21,372,938	\$21,226,741	\$25,123,153



## FINANCIAL COMMENTS

### **Bonds and Stocks**

The Company's custodial agreement for the safekeeping of its assets with Mellon Bank does not contain all of the requirements of N.D. Admin. Code § 45-03-23-02.

**It is recommended that the Company's custodial agreement for the assets maintained in accounts at Mellon Bank comply with the requirements of N.D. Admin. Code § 45-03-23-02.**

### **Securities Lending**

The Company has a securities lending agreement with Mellon Bank. At December 31, 2003, the market value of bonds loaned to one borrower exceeded the 5% of admitted asset limitation set forth in N.D. Admin. Code § 45-03-12-04(5).

**It is recommended that the Company establish lending limits so that at any given time the market value of loan(s) to a single entity borrower cannot exceed the 5% of admitted asset limitation set forth in N.D. Admin. Code § 45-03-12-04(5).**

## CONCLUSION

The financial condition of the Company, as of December 31, 2003, as determined by this examination is summarized as follows:

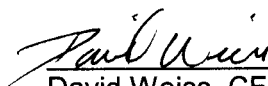
ADMITTED ASSETS		<u>\$105,293,044</u>
Total Liabilities		\$80,169,891
Common Capital Stock	\$ 1,500,000	
Surplus Notes	6,000,000	
Gross Paid In and Contributed Surplus	6,850,255	
Unassigned Surplus	<u>10,772,898</u>	
Surplus As Regards Policyholders		<u>25,123,153</u>
LIABILITIES AND SURPLUS		<u>\$105,293,044</u>

Since the last examination conducted as of December 31, 1999, the Company's admitted assets have increased \$28,420,599, its total liabilities have increased \$20,052,004, and its surplus as regards policyholders has increased \$8,368,595.

The unassigned surplus as determined by this examination represents no change from the amount reported in the Company's 2003 annual statement. The financial statement differences detected by the examiners were deemed immaterial and no changes were made as a result of this examination.

The cooperation and assistance extended by the officers and employees of the EMC Group, during the course of this examination, is hereby acknowledged.

Respectfully submitted,



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David Weiss, CFE  
Examiner in Charge

## **SUBSEQUENT EVENTS**

In 2004, the Company increased the estimates for loss and loss adjustment expense reserves for prior accident years by \$5,088,000. The 2004 reserve increase consisted of the following items and amounts:

Reported claims in excess of carried IBNR	\$3,140,000
Development on case reserves of previously reported claims	2,348,000
Bulk reserve strengthening	500,000
Settlement expense reserve increases resulting from increases in case reserves	1,321,000
Ceded reinsurance recoveries on case reserve development and IBNR emergence	(2,221,000)
Total	<u>\$5,088,000</u>

Case reserve strengthening primarily in the workers compensation and other liability lines of business was the primary reason for the adverse reserve development in 2004. The economic factors behind this case reserve strengthening include, most notably, an increase in workers compensation claim severity, increases in construction defect claim activity, the recent occurrence of several large umbrella claims, and increasing legal expenses in the other liability line of business.

On December 29, 2004, the Company received an \$8,052,632 capital contribution from its parent company, EMC Insurance Group Inc., in connection with the parent company's follow-on stock offering.

Effective January 1, 2005, the Company's participation in the pooling agreement increased from 5% to 6.5%.

## **SUMMARY OF RECOMMENDATIONS**

It is recommended that the Company's custodial agreement for the assets maintained in accounts at Mellon Bank comply with the requirements of N.D. Admin. Code § 45-03-23-02.

It is recommended that the Company establish lending limits so that at any given time the market value of loan(s) to a single entity borrower cannot exceed the 5% of admitted asset limitation set forth in N.D. Admin. Code § 45-03-12-04(5).